HIGHER EDUCATION/Education Department FFEL Auction Program

SUBJECT: **Higher Education Act Amendments of 1998 . . . S. 1882. Kennedy amendment No. 3119.**

ACTION: AMENDMENT REJECTED, 39-58

SYNOPSIS: As reported, S. 1882, the Higher Education Act of 1998, will reauthorize and amend numerous Federal higher education programs.

The Kennedy amendment would put the Education Department, which under the Clinton Administration has worked to eliminate the Federal Family Education Loan (FFEL) Program (also called the Guaranteed Student Loan (GSL) Program), in charge of "pilot" programs to distribute FFEL lending authority by auction. The Education Department favors its troubled direct government lending program over the FFEL program. Under the proposed "pilot" programs, up to 10 percent of FFEL loan volume would be auctioned for 2 years. (BACKGROUND: Most Federal higher education lending is through the FFEL program, which includes Stafford Loans, Federal PLUS loans, and Federal Consolidation loans. Private lenders provide the capital, and the Federal government provides guarantees against loss through default, death, disability, or bankruptcy. This arrangement was instituted because the Federal Government had found that other loan programs that it had created in which the Government gave loans directly had resulted in large losses and inefficiencies. Over the past 33 years, the FFEL has given more than 92 million student loans totaling $245 billion. In 1992, in the last reauthorization of the Higher Education Act, a pilot direct lending program was instituted. A year later, before that pilot program had been adequately assessed, President Clinton and a Democratic-controlled Congress proposed gradually replacing the FFEL with a direct lending program. That proposal was based on the questionable assumption that the Federal Government would be able to loan money more efficiently and effectively than private lenders. By 1994, objective assessments of the new direct lending program started to become available. The new program had 5 percent of total loan volume in 1994, and the Department of Education reported that it could not account for 14 percent of the money that it had loaned. This 14-percent loss did not include any administrative costs or the costs from loan defaults. Also, it did not include the cost the Government incurred from having itself to borrow money so that it would have money to lend. The direct lending program has

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YEAS (39)		NAYS (58)		NOT VOTING (3)	
Republicans (0 or 0%)	**Democrats (39 or 89%)**	**Republicans (53 or 100%)**	**Democrats (5 or 11%)**	**Republicans (2)**	**Democrats (1)**
	Akaka Biden Bingaman Boxer Breaux Bryan Bumpers Byrd Cleland Conrad Dodd Dorgan Durbin Feingold Feinstein Glenn Graham Harkin Hollings Inouye Johnson Kennedy Kerry Kohl Landrieu Lautenberg Levin Lieberman Mikulski Moseley-Braun Murray Reed Reid Robb Rockefeller Sarbanes Torricelli Wellstone Wyden	Abraham Allard Ashcroft Bennett Bond Brownback Burns Campbell Chafee Coats Cochran Collins Coverdell Craig D'Amato DeWine Domenici Enzi Faircloth Frist Gorton Gramm Grams Grassley Gregg Hagel Hatch Helms Hutchinson Inhofe Jeffords Kempthorne Lott Lugar Mack McCain McConnell Murkowski Nickles Roberts Roth Santorum Sessions Shelby Smith, Bob Smith, Gordon Snowe Specter Stevens Thomas Thompson Thurmond Warner	Baucus Daschle Ford Kerrey Leahy	Hutchison-2 Kyl-2	Moynihan-2

EXPLANATION OF ABSENCE:
1—Official Business
2—Necessarily Absent
3—Illness
4—Other

SYMBOLS:
AY—Announced Yea
AN—Announced Nay
PY—Paired Yea
PN—Paired Nay

continued to grow, and it has continued to be plagued by problems. It currently comprises 32 percent of total loan volume, though Democrats in 1993 planned for it to comprise 100 percent of total loan volume by this date. The Education Department Inspector General audited 16 direct loan schools in 1996 and found 8 major weaknesses in all 16 of those programs, including that 53 percent of student status reporting was inaccurate, 71 percent of student records in the national student loan data system were inaccurate, 58 percent of transactions were not reported by schools through the Department in a timely manner, and the Department did not have a process to match specific drawdowns with specific disbursement transactions. In 1997, the Department had so erroneously miscalculated the volume of consolidation loans and the length of time required to consolidate those loans that Congress had to pass a 1-year emergency consolidation bill to let students go through the private sector instead. Last year it sent out 2.7 million forms with the wrong shading on them, so the forms ended up being processed incorrectly. Currently, none of the Education Department's computer systems that are responsible for the accurate delivery of nearly $50 billion in financial assistance are year-2000 compliant, and only 14 percent of its mission-critical computers have been renovated for the year-2000 date change.)

Those favoring the amendment contended:

The Kennedy amendment should be favored by all of those Senators who are constantly championing the virtues of the free market. It would start a pilot program that would allow lenders, through the free market, to set the interest rate subsidy that the Federal Government should pay. Right now, the Government just picks a rate above a given Treasury note rate that it says it will pay. It has no way of knowing if that rate is the best rate that it can get. To get around this problem, the Kennedy amendment would have the Federal Government ask for bids on the rates at which lenders would be willing to join the program. The taxpayers would end up saving substantial sums of money. The Government has used auctions in many other areas in order to save money. Logically, it should work for student lending as well. We urge our colleagues to support this amendment.

Those opposing the amendment contended:

Most students and universities have found that the FFEL Program serves their needs better than the direct lending program. Our liberal colleagues are frustrated by this fact, and instead of working to make the direct lending program better they are trying to find ways to destroy the FFEL program in order to force students and colleges, against their will, into the direct lending program. With this particular amendment, our colleagues want to take 10 percent of the FFEL loan volume and put it under the control of new Department of Education auction "pilot" programs. This proposal is objectionable for two reasons. First, it is too large--it would essentially experiment on hundreds of thousands of student loans. Second, it would put the Department of Education, which is hostile to FFEL lending, in charge of the pilot programs. Hundreds of thousands of students would be shoved into brand new "pilot" programs that we believe very likely would be deliberately designed to run poorly. Those students' educations would be put at risk.

We are not hostile to the idea of using auctions for the FFEL program. The concept should be studied further, and this bill will require the Department of Treasury, which itself uses auctions extensively, to study whether it can be made to work for student loans. Our initial, main concern with the idea is that auctions may put too much emphasis on cost, ignoring that FFEL loans are supposed to be provided as a social benefit. Loans generally should be available to prospective students without regard to credit history, educational program, loan size, geographic location, or potential as a consumer of future credit products. If cost becomes the driving factor, the program may end up having a bias in favor of giving loans to wealthier students who least need to borrow money. Further, any changes to the delivery system must strive to preserve the high level of service that students and institutions of higher education currently enjoy.

We frankly hope that the Treasury Department can come up with an auction model to overcome these problems because we favor competition. If our colleagues are serious about wanting competition, we may be able to find a grand compromise by coming up with a proposal that applies both to the FFEL program and to their direct lending program, which does not have any competitive elements. The Kennedy amendment, though, is not a serious proposal. It would serve only to undermine the FFEL program, and to put the educations of hundreds of thousands of students at risk. We strongly urge the rejection of this amendment.